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**FISCAL IMPACT STATEMENT**

**LS 6755**

**BILL NUMBER:** SB 186

**NOTE PREPARED:** Dec 16, 2004

**BILL AMENDED:**

**SUBJECT:** Inheritance Tax Valuations.

**FIRST AUTHOR:** Sen. Zakas

**BILL STATUS:** As Introduced

**FIRST SPONSOR:**

**FUNDS AFFECTED:** ☒ **GENERAL**  
☒ **DEDICATED**  
**FEDERAL**

**IMPACT:** State & Local

**Summary of Legislation:** The bill requires county Inheritance Tax appraisers and the Department of State Revenue to use current (rather than 1988) mortality standards and actuarial tables when appraising certain property interests and annuities.

**Effective Date:** July 1, 2005.

**Explanation of State Expenditures:** The federal Internal Revenue Service (IRS) actuarial tables are more detailed than the tables currently used in Indiana. The use of the IRS tables will affect the administration of the Inheritance Tax. Because the applicable interest rate may change each month, the table used to determine the value of property and assets may also change each month. The use of the federal tables would require the purchase of new software calibrated with the IRS actuarial tables and federal midterm interest rates, and training for state officials on the use of the new tables and software. In addition, the change could potentially increase the number of employees needed in the Inheritance Tax Section of the Department of State Revenue (DOR) to assist county appraisers and other users of the actuarial tables.

The funds and resources required above could be supplied through a variety of sources, including the following: (1) existing staff and resources not currently being used to capacity; (2) existing staff and resources currently being used in another program; (3) authorized, but vacant, staff positions, including those positions that would need to be reclassified; (4) funds that, otherwise, would be reverted; or (5) new appropriations. The November 4, 2004, state staffing table indicates that the Inheritance Tax Division has 12 full-time employees with an annual salary of about \$335,000. The Division also has 2 vacant full-time positions. The staffing table indicates that the DOR has 88 vacant full-time positions. The DOR reverted \$3.0 M to the General Fund for FY 2004. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will

depend upon legislative and administrative actions.

**Explanation of State Revenues:** A change in the interest rate used to determine the taxable value of physical property, annuities, life estates, and other assets from 10% as currently used in the state of Indiana to the IRS requirement of 120% of the annual midterm applicable federal rate for the month in which the valuation date falls is likely to affect Indiana Inheritance Tax revenues and the distribution of the tax among transferees. However, an estimate of the change in Inheritance Tax revenues attributable to using the federal tables cannot be determined from the data available in the OFMA Inheritance and Estate Tax Databases. Currently, the 120% of the annual midterm applicable federal rate is significantly lower than 10%. For example, the November 2004 rate equal to 120% of the annual midterm applicable rate is 4.26%.

*Estimation Issues:* In the case of a life estate where the spouse holds the life estate and the children the remainder, which is one of the more common uses of these tables, the current use of the 10% interest rate overvalues the life estate and undervalues the remainder relative to values that would be determined using the applicable federal rate. As a result, the use of the federal tables is likely to increase the tax liability accruing to the remainder to the extent that the additional value of the remainder exceeds the \$100,000 exemption for Class A transferees. The Inheritance Tax for the aforementioned estate is likely to increase since the portion of taxable value held by the remainder, Class A transferees, has increased and the amount of the estate exempt from taxation has decreased. However, for other combinations of taxpayer classes (A, B, C, or exempt), this may not be the case. As a result, this redistribution of taxable value may increase, decrease, or not change Inheritance Tax due from a particular estate depending on the taxpayer class of the transferees, the type of assets being valued, and the method of transfer specified in the decedent's will.

*Background:* The tables that the DOR and county officials currently use have been used since October 1, 1988. A 10% interest rate is used in each of the tables, and the mortality rates used to calculate the actuarial tables are from the previous decade, according to officials with the Department of State Revenue. These tables are used to determine the taxable value of property, annuities, life estates and the remainder, and other physical and financial assets for which a future value needs to be determined for the Indiana Inheritance Tax. The bill requires that state and county officials use the actuarial factors presented in the IRS Actuarial Values tables. The IRS has used these tables since July 1999. These actuarial values are based on interest rates ranging from 2.2% to 22.0% in intervals of 0.2%. The range of interest rates in these tables are provided because Section 7520 of the Internal Revenue Code requires the use of an interest rate (rounded to the nearest 2/10ths of 1 percent) of 120% of the annual midterm applicable federal rate for the month in which the valuation date falls for remainder, income and annuity factors (Book Aleph), unitrust remainder factors (Book Beth), and depreciable property (Book Gimel). All of the actuarial factors in these tables reflect annual compounding of interest. The IRS posts the 120% applicable federal rates each month.

The mortality tables, used to construct the IRS actuarial values, are derived from the Life Table for the Total Population appearing as Table 1, in "U.S. Decennial Life Tables for 1989-1991" published by the U.S. Department of Health and Human Services, Public Health Service, National Center for Health Statistics. The federal code requires that the actuarial values be revised once each ten years to take into account the most recent mortality rates available at the time of revision.

**Explanation of Local Expenditures:** The transition to using the federal actuarial tables may involve expenditures related to the purchase of new software and the training of county appraisers.

**Explanation of Local Revenues:** Currently, counties retain 8% of the Inheritance Tax collected from Indiana

residents. Local revenue may be affected by changes in taxable value due to the use of the federal actuarial tables. An estimate of the increase (or decrease) in county Inheritance Tax revenues cannot be determined.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties.

**Information Sources:** Actuarial Values Book Aleph – IRS Publication 1457 (7-1999) -- available at <http://www.irs.gov/pub/irs-pdf/p1457.pdf>, Actuarial Tables Book Beth – IRS Publication 1458 (7-1999) -- available at <http://www.irs.gov/pub/irs-pdf/p1458.pdf>, Actuarial Values Book Gimel – IRS Publication 1459 (7-1999) -- available at <http://www.irs.gov/pub/irs-pdf/p1459.pdf>, the Index of Applicable Federal Rates available at <http://www.irs.gov/taxpros/lists/0,,id=98042,00.html>, Current Indiana Actuarial Tables A, B and C.

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